Boenning Morning Comment

This report is prepared for us by Tower Bridge Advisors June 4, 2010

Stocks finished mixed yesterday with the NASDAQ sporting nice gains. Trading was fairly active. It wasn't that second good day in a row that would trigger my two-day rule but it wasn't a washout either. There were some good pockets of buying within the market notably among tech and natural gas stocks. Stocks rallied from a mild mid-afternoon deficit when it would have been easy for sellers to take command and lead share prices sharply lower once again. But not all was good either. Except for the aforementioned tech and natural gas names, there was little buyer interest. Notably, the financials lagged. If the nascent recovery is going to survive, the financial sector has to get stronger and stay healthy.

This morning's big news is the labor report. I will talk more about that in a moment. Prior to that futures had been strong but reversed quickly when rumors spread of a major derivatives loss within a large French bank and stories from Hungary suggested that the nation was on the bring of default. The headline risk to these stories is obvious. But the long term damage from either, if any, is still unclear. Hungary doesn't matter a whole lot to world economic growth nor does one big derivatives loss. But the health of the banking system does matter. If a loss here and a default there add up cumulatively to numbers that force the world banking system to freeze once again, that matters a lot. Clearly the operative word in the previous sentence is if and no one really knows yet. There is scant evidence to date that lending tremors are going to produce anything resembling the fall of 2008. LIBOR rates have been flat all week and we should note that Hungary is not in the EU and major European banks are not huge holders of Hungarian debt. But each tremor shakes the tree a bit and you never really know what is going to fall.

It is all possible this will soon become a bad memory. As we move into June, economic data and second quarter earnings should begin to gain a little more attention. Certainly this week's data is supportive of the conclusion that the U.S. economy is recovering. The data wasn't without its warts. Large companies are still reluctant to hire as is clear from today's employment report. Retail sales in May were OK at best. State and local governments are laying off people as they work to balance budgets. Stimulus money is coming to an end. Housing activity is stalling at least momentarily as the last of the new buyer tax incentives expire. But every indicator still suggests growth; the only question is rate. And so far there are few signs even within Europe of notable slowdowns caused by sovereign debt related events.

I still believe that what has been happening for the past five weeks or so is an adjustment process related to lower growth expectations for 2011. Once again, the reasons for slower growth in 2011 are higher taxes, more regulation, less fiscal stimulus and modest contagion from Europe's debt mess. On the positive side, employment growth will add income and housing will recover. The cessation of deep water drilling in the Gulf should be a modest negative although it could have a strong regional influence in the affected areas. Unknowns include any further tax changes (the news flow from Washington is remarkably inconsistent), the impact of financial reform and regulators on bank lending, and the ultimate impact of the European debt crisis. But if growth next year is closer to 2% that the consensus 3-4%, earnings growth will be a lot more modest than most currently expect. The adjustment process won't be done in a day. While most of the market adjustment may already be in place, it will take a while for analysts and company managements to get and spell out a clearer picture. As estimates are lowered, individual stocks will feel the effect.

I want to switch gears and briefly revisit two topics. The first is the Gulf oil spill. Without all the details, it is completely obvious to all that the fiasco is a direct result of human error on the part of BP and failed oversight by

MMS, the government agency charged with oversight responsibility. Unfortunately, we have seen this pattern before. We saw it most recently in the Massey Energy coal disaster. We saw it pervasively in the sub-prime housing crisis. Capitalism requires rules to prevent bad behavior and regulators to enforce the rules. If regulators don't perform their tasks, all the rules in the world won't matter. While there may be needs for further redundancy in deep water drilling as safeguards, there is little question that technology exists today to drill safely. But it isn't fair to assume that all companies focused on maximizing profits will put safety before the almighty dollar. That is why we have regulators. I realize Washington never admits mistakes but it would be an economic and political disaster to shut down oil drilling to save political face. The damage to our economy would be in the hundreds of billions of dollars. We would end up buying more oil from our enemies. The obvious solution is to do a better job of regulation and to punish corporations severely in the future who abuse the privilege of drilling for oil in our waters.

Second, I hope the SEC reads the Wall Street Journal. The lead story in the Money and Investing section tells how computerized traders get data from stock exchanges seconds before others, feed it into computers and then trade ahead of everyone else. Does the SEC need any better evidence that the playing field isn't level? This isn't the only example. It is one example. Simply said, the rules of engagement are broken. Traders win at the expense of investors. The conclusion is obvious. If the rules aren't changed, investors will leave and traders will continue to add volatility to markets without adding value. So far, the SEC response has been to add circuit breakers for single stock trading. That isn't a solution any more than aspirin is a therapeutic solution to pneumonia.

Finally, I will briefly discuss the May labor report. The headline number of plus 431,000 jobs sounds great but when you look deeper and see that 411,000 census workers were added on a temporary basis, the numbers were not very good. Futures fell sharply on the number. The key is that large companies still aren't hiring. Everything this administration has done lately has been negative to jobs growth. Health insurance reform is going to increase fringe costs sharply. Other reform packages haven't been completed yet but the regulatory burden is going to rise. Stimulus spending is running out. That means less economic growth and it will lead to sharp contractions in state and local government employment. European contagion is an unknown. So are taxes. As a result, companies are hiring to meet current needs, and are not encouraged about building for future growth. Washington's anti-business rhetoric isn't helping. The lynchpin to economic growth is jobs creation. Everyone in Washington understands this but actions to date are counterproductive. Maybe today's numbers will be a wake up call that fighting populist wars with business isn't the right path to take. I don't want to be totally dour this morning. Let me note a few positives in the employment report. First, the average hours worked continued to increase, a precursor to future growth. Second, even though the census jobs are temporary, they do add to the economy. Third, the unemployment rate fell from 9.9% to 9.7%. But with that said, the private sector is not adding jobs at a rate most economists would want to see at this point in the cycle.

Today Angelina Jolie is 35. So is Russell Brand (new movie today). Dr. Ruth Westheimer turns 82.

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